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No. 94

In the Supreme Court of the United States

OCTOBER TERM, 1963

UNITED STATES OF AMERICA, *Appellant*,

vs.

EL PASO NATURAL GAS COMPANY, et al., *Appellees*.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

BRIEF OF APPELLEE EL PASO NATURAL GAS COMPANY

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January 31, 1964

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QUESTION PRESENTED

The complaint charged (R. 6-7)[1] that the acquisition of the stock and assets of Pacific Northwest Pipeline Corporation ("Pacific Northwest") by El Paso Natural Gas Company ("El Paso") had anti-competitive effects (1) in the transportation and sale of natural gas in "several western states", so that all other potential competitors might be permanently excluded and El Paso control all transmission of out-of-state gas, including foreign gas, into the western

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1. "R. ....." refers to the printed record. "Gov't Br." refers to the Brief of the United States on this appeal. "Fdg." refers to the District Court's Findings of Fact and Conclusions of Law. The page number in the original transcript at which each exhibit referred to herein was admitted in evidence is listed in Appendix A to the Brief of the United States.

states, and (2) in the production and purchase of natural gas in the San Juan Basin and other natural gas fields.[2]

The Government has now completely abandoned its claim concerning the production and purchase of natural gas. It has also abandoned most of its claim concerning the transportation and sale of natural gas in the western states. It confines its appeal from the dismissal of the complaint solely to a claim of future anti-competitive effects "in the sale of natural gas in California."[3] (Gov't Br. 2)

On the trial of the issues concerning the transportation and sale of natural gas, it was proved and found that prior to the acquisition El Paso and Pacific Northwest never served the same markets or the same buyers.[4] Pacific Northwest was designed, certificated and built to serve, and served principally, the northwest states of Oregon, Washington and Idaho. El Paso served principally California (where Pacific Northwest never served) and the southwest states. (Fdgs. 22, 31-32, R. 50-52; Fdgs. 54-66, R. 57-59)

It was also proved and found that since the date of the acquisition in 1957, despite the complaint's prognosis of exclusion and control by El Paso, substantial new entry

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2. A further charge in the complaint of anti-competitive effects in the production and sale of natural gas *by-products* and *oil products* was abandoned at the trial without attempt at proof.

3. Much of the Government's evidence at the trial was devoted to an attempt to prove that there were six overlapping geographic "markets" involved in the issues concerning the transportation and sale of natural gas, including an eleven-state market, a ten-state market, an eight-state market and a three-state market, as well as a market consisting of the state of California and a market consisting of southern California. These alleged multi-state markets, and any claim of anti-competitive effects therein, have all been abandoned by the Government.

4. There were sales of gas for use in Utah by an El Paso subsidiary, Utah Natural Gas Company (from relatively small intrastate gas reserves in Utah), and by Pacific Northwest, which were found to have no competitive significance (Fdgs. 25, 56-58, R. 50, 57-58) and are not involved in this appeal (Gov't Br. 30-31).

has occurred in California. Two major pipelines, one of them an affiliate of Pacific Gas and Electric Company, and the other organized by large producing interests, including Gulf Oil Corporation, have been certificated to sell to California over 700 million cubic feet daily of out-of-state gas, including 415 million cubic feet daily of Canadian gas. In addition, Tennessee Gas Transmission Company, through a subsidiary, has made application to the Federal Power Commission to construct a large diameter pipeline from Texas to California. (Fdgs. 78-80, 82-84, R. 61-63) Several other groups, including producers and pipeline companies, have also demonstrated their interest in supplying competitive gas to California (see pp. 27-29 *infra*). The Government itself cites various of the developments in the sale of gas to California as demonstrating the "ample opportunities" open for competition after the acquisition (Gov't Br. 46).

Further in contravention of the complaint's claims of market "dominance" by El Paso and "control" as a result of the acquisition, the Government accepts and adopts the principle found by the District Court that in the natural gas industry the segments of market demand served pursuant to certificates issued by the Federal Power Commission are by law not subject to competition from others (Fdg. 53, R. 57; Gov't Br. 29).[5] The Government likewise does not dispute the finding that, with respect to the portion of market demand not already served pursuant to Federal Power Commission certificate, El Paso by reason of the acquisition gained no advantage over others to supply future California demands for out-of-state natural gas,

5. Under Section 7(b) of the Natural Gas Act, also, a company performing a certificated service has the duty to continue to perform that service under penalty of criminal sanctions, until authorized by the Federal Power Commission to abandon or discontinue the service. 15 U.S.C. § 717f(b).

and in various respects is at a competitive disadvantage (Fdg. 87, R. 63-64; Gov't Br. 31-32).

The Government concedes, moreover, that El Paso did not have any anti-competitive purpose in acquiring Pacific Northwest, and that El Paso's purpose was to obtain additional gas supplies and reserves to meet its continuing obligations under its certificated contracts (Fdg. 40, R. 54). Admittedly El Paso since January 1, 1957 has made no sales or deliveries of natural gas to California under long-term contracts in excess of its commitments existing on that date (Fdg. 88, R. 64). And the Government does not dispute the finding that to serve any new demand in California it would be necessary for El Paso to acquire new supplies or reserves as well as to make feasible arrangements to construct new pipeline facilities (Fdg. 87, R. 63).

The Government has thus acknowledged the demolition of any claim of market "dominance" or "control" by El Paso in the sale of natural gas in California, and that the acquisition, from which El Paso gained no competitive advantage in California, is to be tested in terms of its effect on competition to serve demand for gas in California not already served pursuant to Federal Power Commission certificate.

The sole question presented on this appeal, therefore, is whether the District Court was clearly in error in finding that the Government failed to sustain its burden of proving by a preponderance of evidence a reasonable probability that the acquisition and merger would have the effect of substantially lessening competition in the sale of natural gas to or for use in California.

While the Government's formulation of the question under its heading "Question Presented" (Gov't Br. 2) is

consistent with this statement,[6] the Government's argument distorts the issue by ignoring the structure of the market and the nature of competition in California, and by misstating the findings concerning Pacific Northwest's operations and the failure of proof in respect of any alleged lessening of competition.

The Government's argument is pitched on the assertion that Pacific Northwest would be a "substantial competitive factor" in promoting future projects to supply future increments of market demand in California for out-of-state natural gas; that such substantial competitive factors are today limited to three interstate pipelines (and with Pacific Northwest would have been four); and that the sole fact of Pacific Northwest's disappearance as a separate company constituted the proscribed effect on future competition for the sale of natural gas in California. This approach fails to take account of the competitive position of the distribution companies (Pacific Gas and Electric Company and the Southern California Companies), the competition of intrastate gas, the efforts by industrial users to buy gas directly from producers, the existence of pipelines with surplus ultimate capacity, the score of other pipeline companies and producers which are identified in the record as having expressed an interest in selling gas to the California market, and the numerous other pipelines and producers with undedicated reserves within economic reach of California.

The Government also argues that the District Court's findings on the competitive capacity of Pacific Northwest were limited to speculation about whether Pacific Northwest

6. The Government's Notice of Appeal, Jurisdictional Statement and Brief consistently describe the alleged effects only in terms of substantially lessening competition. No claim is made in this appeal that the acquisition and merger may tend to create a monopoly.

actually would have *sold* gas in California pursuant to Federal Power Commission certificate. We must point out at the outset that the findings are not as the Government characterizes them and that the Court did not speculate when it found that the record did not show that Pacific Northwest had a reasonable likelihood of providing any substantial competition for the sale or transportation of natural gas in or for use in California. Its findings were based on (i) the actual structure of the market and the actual state of competition in the transportation and sale of natural gas to or for use in California, and (ii) Pacific Northwest's lack of capacity to be a substantial or effective competitor in California. El Paso contends that the record and the findings, virtually undisputed by the Government, compel the dismissal of the complaint for failure of proof of any anti-competitive effects resulting from the acquisition.

THE PROCEEDINGS BELOW

Following this Court's decision on April 30, 1962 in *California v. FPC*, 369 U.S. 482, that the Commission should not have acted to authorize the merger pending the outcome of the antitrust suit under Section 7 of the Clayton Act, a trial was held in September 1962, with final oral arguments in October. Care was taken by the parties and the District Court to deal with the issues solely as Clayton Act issues, and the Government makes no claim of any error in this regard.

The trial, including oral argument, took seven days. Although the Brief for the United States (Gov't Br. 19-20) characterizes the evidence as consisting "to a great extent" of transcripts of testimony and exhibits before regulatory agencies in previous proceedings (virtually all of such transcripts and exhibits having been introduced as a matter

of convenience by the Government itself), the fact is that 18 witnesses took the stand at the trial, including executives of Pacific Gas and Electric Company, the southern California distribution companies and Southern California Edison Company, a representative of the Department of Water and Power of the City of Los Angeles, and the Chairman of the Board and the President of El Paso, as well as the chief executives of the Washington and Oregon distribution companies.

The Government did not file a single exception to the Findings of Fact and Conclusions of Law submitted by El Paso and adopted by the Court (R. 45-72; Rule 52(b), Federal Rules of Civil Procedure). In this Court, the Government does not question the sufficiency of the evidence to support the findings, except to assert that certain of the findings it considers to be irrelevant are invalid "as applied to the long run" (Gov't Br. 26, 46, 50-51, 59), and as heretofore noted it has also abandoned in this Court virtually every claim which it asserted and lost in the Court below.

STATEMENT OF THE CASE

A. Description of the Natural Gas Industry.[7]

1. Sources and Uses of Natural Gas.

Natural gas, a wasting natural resource consisting primarily of hydrocarbons, is an important source of heat and energy. It is obtained either as "dry" gas from gas wells, or as "wet" or "residue" gas from oil wells from which it is produced in connection with the production of oil. It is found in underground strata or reservoirs in various fields

7. As Congress has indicated, and this Court has emphasized, a merger must be "functionally viewed, in the context of its particular industry." *Brown Shoe Co. v. United States*, 370 U.S. 294, 321-2 (1962).

or basins located for the greater part in an area extending from the Gulf Coast of Louisiana through Texas and Oklahoma to the Rocky Mountains, and thence in a northerly direction to Canada and in Canada itself. Such fields and basins are also found throughout California. (Fdgs. 7-10, R. 47)

The principal demand for natural gas is in the larger population centers of the country and, as shown on the Federal Power Commission's map (R. 895), it is transported to the various metropolitan areas from the producing fields by pipelines, which are the only practical means for moving natural gas substantial distances from the field to the markets. Pipelines may be owned and operated by producers, pipeline companies, distribution companies, or a combination. (Fdgs. 14-16, R. 48)[8]

Natural gas is in direct competition with other sources of energy, particularly fuel oil and electricity, in California as well as the Northwest (Fdg. 13, R. 48). Sales for residential and commercial uses are upon a firm demand basis, while those for industrial use (including use as boiler fuel) are upon an interruptible basis, that is, the deliveries

8. Companies whose activities in respect of natural gas are devoted to the exploration for, and the development and production of, natural gas for sale within fields of production, are usually referred to as "*producers*" or "*independent producers*"; included in this category are large oil companies which also may, and sometimes do, establish affiliates to transport natural gas from the fields of production to distribution centers. Companies which are engaged in transporting natural gas from the fields of production to distribution centers are usually referred to as "*pipeline companies*"; but pipeline companies frequently engage as well in the exploration for and the development and production of natural gas. Companies which own and operate the distribution systems and sell natural gas to the ultimate consumers in the metropolitan centers are usually referred to as "*distribution companies*". Distribution companies also may own (directly or through affiliates) main line transmission systems reaching from the fields of production to the centers of distribution, and may, and sometimes do, explore for, develop and produce natural gas in the field.

are subject to curtailment or discontinuance when the gas is needed to meet the needs of domestic and commercial customers. Such interruptible sales to industrial users improve the load factor (*i.e.*, increase the average daily use of the facilities), and thus assist in keeping down rates to the benefit of residential and commercial users. (Fdg. 12, R. 48)[9]

2. Long-Term Gas Delivery Commitments.

The construction and expansion of long-distance pipelines are dependent upon a market being available on a long-term basis and upon adequate gas supplies and reserves firmly committed thereto. On the market end, interstate sales of natural gas are made pursuant to long-term contracts which usually extend for 20 years. (Fdg. 17, R. 49; Gov't Br. 28)

Such long-term commitments and arrangements arise out of the need of the public and of the distribution companies to have adequate, continuous and dependable supplies and service at reasonable rates, and of the pipeline companies to justify the equity investment and debt financing required for the construction of transmission facilities and the acquisition of gas reserves and supplies. (Fdg. 18, R. 49; Gov't Br. 28)

3. Investments in the Natural Gas Industry.

The result of these needs and commitments in the natural gas industry is that large sums must be invested in the acquisition, development and dedication of adequate present

9. See *American Louisiana Pipe Line Co.*, 20 F.P.C. 575, 592 (1958), where the Commission refused to certificate firm sales by a pipeline company directly to industrial customers in Chicago: "The steel sales are important to the distributors, for such interruptible sales improve the load factors to the benefit of the low load factor commercial and domestic consumers. It is indicated that the loss of the steel sales might require the distributing companies to raise their rates."

and future gas supplies and reserves, and in the construction, expansion, operation and maintenance of pipeline facilities to transport the natural gas from the producing areas to market. (Fdg. 19, R. 49)

For example, the complaint alleges that El Paso has assets of approximately a billion dollars. The company's financial statements show that its investment now exceeds that amount; on December 13, 1961, El Paso's net plant investment after depreciation was $1,334,200,000. Although references to the extent of the corporate resources of El Paso make their appearance from time to time in the Brief of the United States (*e.g.*, Gov't Br. 25), the Government does not contend that "bigness" of El Paso or of El Paso combined with Pacific Northwest is a significant factor. It is clear that El Paso's investment has been made to develop supplies and build its pipeline system from the producing basins to its western markets,[10] and was dedicated by El Paso to its interstate natural gas business to fulfill its contract commitments. These commitments were certificated by the Federal Power Commission and in the case of contracts with California distribution companies, also approved by that state's Public Utilities Commission. (Fdgs. 48-50, R. 55-56)

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10. The character of investment required in natural gas pipelines is readily seen by reference to decisions of the Federal Power Commission, which show the extremely large amounts involved in the construction of facilities for transportation, in addition to the expenditures necessary for the discovery and development of the natural resources in the ground. The expenditures by El Paso for various projects certificated by the Federal Power Commission (reported in 5 FPC 115, 8 FPC 726, 12 FPC 1037, 14 FPC 157, 16 FPC 1354) were respectively, $70,000,000, $52,000,000, $132,000,000, $84,658,000, $107,000,000 and $184,000,000. The Commission certificated construction of the new Transwestern pipeline to California at a cost of $191,000,000 (Fdg. 79, R. 61-62). Pacific Gas Transmission Company built its line from the International Border to California at a cost of $133,000,000 (Fdg. 80, R. 62).

Even Pacific Northwest, undercapitalized as it was and without sufficient funds to permit development of its gas supplies and reserves (*infra* pp. 17-18), had an investment of a quarter of a billion dollars in facilities and resources certificated to serve the Northwest.

Accordingly, the facilities and investment in gas supply resources dedicated to certificated service are such as are required to fulfill such public service obligations. And, as discussed *infra* p. 13, such facilities and resources must be continued unless otherwise authorized by the Federal Power Commission. (Fdgs. 49-53, R. 56-57)

The distribution companies also require extensive capital for their public service activity. Pacific Gas and Electric Company ("PG&E"), which distributes natural gas and electric energy in northern and central California, has assets in excess of two and one half billion dollars and operating revenues of almost $700,000,000 a year. PG&E is a noteworthy example of this aspect of the natural gas industry, since it not only distributes natural gas in California, but purchases natural gas in Canada and transports the gas through its own interstate pipeline affiliate to the border of California, thus being a vertically integrated natural gas company from production through interstate transportation to final distribution to the public. (Fdgs. 67, 68, 70, 80, R. 60-62; R. 967[11])

4. The Regulation of Natural Gas Companies and Its Significance to Competition.

Governmental regulation, both federal and state, of operations in the natural gas industry, while a matter of law, is also in this case a matter of significant fact: it not only

11. The figures for PG&E's assets and revenues appear at p. 27-28 of DX H, the Annual Report of PG&E for 1961; the page was not reprinted in the record.

affects the economics of the industry (for example, by insistence upon financial ability, adequate long-term supply contracts and adequate assurances of reserves), but it is a significant determinant of what competition there can be and the way in which effective competition can be pursued. See *United States v. Philadelphia National Bank*, 374 U.S. 321, 324 *et seq.* (1963).

As the Court has repeatedly stated, the underlying purpose of the Natural Gas Act adopted by Congress in 1938 was to insure that the sale of natural gas in interstate commerce for resale be made at the lowest possible reasonable rates to the public consistent with the maintenance of adequate service. *Atlantic Refining Co. v. Pub. Serv. Comm'n* ("Cateo"), 360 U.S. 378 (1959); *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). It was upon this theory—the establishment of just and reasonable rates to the consumer—that the *Phillips* decision held in 1954 that sales by producers of natural gas in interstate commerce were subject to the terms of the Act.

Under the Natural Gas Act (52 Stat. 821, as amended, 15 U.S.C. § 717 *et seq.*), no sale of gas for resale in interstate commerce can be made by a producer or a pipeline, and no facilities for interstate sale or transportation of gas may be installed or operated, except pursuant to a certificate of public convenience and necessity issued by the Federal Power Commission, on evidence and findings that the proposal is in the public interest (Section 7(c), Natural Gas Act). These findings for a pipeline certificate must establish also that the applicant is financially capable of initiating and successfully carrying out the proposed project, that a market demand exists and that natural gas supplies are available and adequate to meet it. While rate proceedings are conducted separately from certification pro-

ceedings, the Federal Power Commission may, and frequently does, attach conditions with respect to rates in a certification proceeding in connection with its determination of the public convenience and necessity and the economic feasibility of the new project (Section 7(e), Natural Gas Act; *City of Pittsburgh v. FPC*, 237 F.2d 741, 751 fn 28 (D.C. Cir. 1956). Once facilities have been installed and service commenced pursuant to the Commission's certificate, there is a dedication to public service and they cannot be abandoned without the permission of the Commission (Section 7(b) Natural Gas Act; *Sunray Mid-Continent Oil Co. v. FPC*, 364 U.S. 137, 153-4 (1960); *Atlantic Refining Co. v. Public Service Comm'n*, 360 U.S. 378, 389 (1959)).

In pursuance of the Natural Gas Act, El Paso from time to time applied for and was granted certificates of public convenience and necessity authorizing and requiring it to supply natural gas to California and to the southwest states (R. 408-409, 895). Each California transaction was also subject to approval of, and was approved by, the California Public Utilities Commission (Fdg. 49, R. 56).[12]

At the time of the acquisition, Pacific Northwest was authorized and required by Federal Power Commission certificate to sell natural gas in the states of Washington, Ore-

12. Since the California distribution companies purchase their supplies of interstate natural gas at the California border, the pipeline facilities necessary to transport that gas within California must be certified by the California Public Utilities Commission, which also has the power to determine whether the project is in the public interest and whether the price and other terms are reasonable. For example, in the application for the Rock Springs project, although the initial application was approved by the Federal Power Commission, the California Public Utilities Commission ordered certain terms as to price, time of delivery and utilization of facilities as conditions to approval of participation by the Southern California Companies. *Southern California Gas Co.*, 58 Cal. P.U.C. 374, 403-4 (1960).

gon, Idaho and parts of Wyoming, Utah and Colorado (Fdgs. 51-52, R. 56).

The result of certification is that the segments of market demand covered thereby are not subject to competition from others. At the same time, El Paso itself is captive to the market demand to which it is certificated. Cf. *Atlantic Refining Co. v. Public Service Comm'n*, 360 U.S. 378, 389 (1959). The facilities and gas supply resources of El Paso (and formerly Pacific Northwest) are dedicated to certificated public service obligations, that service cannot be discontinued unless authorized by the Federal Power Commission as in the public interest, and the rates are subject to Federal Power Commission regulation (Sections 4, 5, 7(b), Natural Gas Act; Fdgs. 50, 52, R. 56). Nor can gas supplies and reserves once connected to interstate certificated markets be divested without Commission approval for they are committed to public service unless abandonment is authorized by the Commission. *Sunray Mid-Continent Oil Co. v. FPC*, 239 F.2d 97, 101 (10th Cir. 1956), *rev'd on other grounds*, 353 U.S. 944 (1957).

It follows from this that the only area for competition in the sale of natural gas is that part of the existing or future market demand not served pursuant to certificate.

B. Description of the Companies.

1. El Paso.

At the time of the acquisition, El Paso was producing and purchasing natural gas in various gas fields and transporting and selling the gas, principally for resale, in California and the southwest states of Arizona, New Mexico, Nevada and Texas. Its natural gas supplies and reserves and pipeline system were dedicated to its certificated long-term sup-

ply contracts to the extent of approximately 2 billion cubic feet a day to California and some 583 million cubic feet a day to the southwest states. It was not competing with Pacific Northwest in any of the states in which Pacific Northwest was performing its certificated natural gas services (*i.e.*, Washington, Oregon, Idaho, Utah, Wyoming or Colorado); nor was there any reasonable likelihood of such competition. (Fdgs. 21-22, 25, R. 50; Fdgs. 48-50, R. 55-56; Fdgs. 54, 58-60, R. 57-58; Fdg. 111, R. 67)

A major portion of El Paso's gas supply consisted of "residue" gas, which must be taken as a by-product of oil as oil is produced. Utilization of such gas involves difficult operating problems for El Paso because of the necessity of balancing daily requirements for gas against wide fluctuations in "residue" gas supply which is keyed, not to El Paso's demand for gas, but to the production of oil by other companies.[13] Oil production is subject to state prorationing and varies not only daily and monthly but also with temperatures and seasons. As a result, the substantial use of "residue" gas (which avoids its waste by flaring) requires large supplies of "dry" gas produced from gas wells, the flow of which can be controlled and used to balance the wide fluctuations in the supply of "residue" gas. (Fdg. 26, R. 50-51)

In addition to its need for "dry" gas to balance its fluctuating supply of "residue" gas in meeting daily requirements, El Paso had a serious overall gas reserve problem at the time of the acquisition and for several years prior

13. El Paso' supply of "residue" gas has varied as much as 500 million cubic feet from day to day. El Paso commenced in 1948 to develop "dry" gas reserves in the San Juan Basin to offset violent swings in the daily availability of "residue" gas. (Fdg. 26, R. 50)

thereto. By 1956 the Federal Power Commission and its Staff seriously questioned the sufficiency of El Paso's natural gas reserves. In July 1956, the Staff asserted that El Paso had but a two-to-three-year supply to meet its long-term certificated commitments.[14] The Federal Power Commission subsequently, in December 1956, agreed with the Staff in this respect. (Fdg. 27, R. 51)

2. Pacific Northwest.

Pacific Northwest was certificated in 1954 to construct a pipeline from the San Juan Basin along the western slope of the Rocky Mountains into Oregon and Washington to serve the Northwest region, the only large area of the country not then served with natural gas (Fdg. 32, R. 52). It had sources of natural gas supplies and reserves in the San Juan Basin and other smaller fields along the route of its pipeline, and later entered into an agreement with Westcoast Transmission Company for the purchase at the border of Canadian gas (Fdg. 33, R. 52).[15] Its natural gas supplies and reserves and pipeline system were dedicated to sales of natural gas in its service areas principally in the Northwest under the terms of supply contracts authorized by the Federal Power Commission. (Fdgs. 51-52, R. 56-57; Fdg. 111, R. 67)

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14. The continuing need of El Paso for supplies and reserves was such that it was necessary for it to purchase approximately a trillion cubic feet of gas annually, in order to replace gas supplies as they were exhausted in the fulfillment of its existing service agreements. (Fdg. 28, R. 51)

15. The contract was for up to 300 million cubic feet per day, but the deliveries have never come to more than 250 million cubic feet per day because, as Mr. Fish explained it, the reserves in the Peace River area turned out to be "worse than we had ever imagined they were." (R. 734)

In 1957, Pacific Northwest suffered an operating loss of $2,067,005.[16] In contrast to predicted earnings of $23,700,000 for the years 1957-59 (rates of return of 5.78%, 8.14% and 8.33% for the years 1957, 1958 and 1959, respectively) upon which Pacific Northwest was certificated in 1954 and 1955 as an economically feasible project, the approximately $248,000,000 investment in the facilities of Pacific Northwest earned only $271,651 in 1958 and $3,619,971 in 1959. Thus the returns for the three-year period were short by about $22 million of the $23.7 million which Pacific Northwest had been expected to show. (Fdg. 39, R. 53-54)

At the time of the stock acquisition Pacific Northwest had a large volume of dry gas reserves, particularly in the San Juan Basin, but nevertheless was confronted with a critical gas reserve problem (Fdgs. 35-37, R. 53):

(i) "Deliverability" (the *rate of flow* from a gas well as distinguished from the *amount* of reserves) in the San Juan wells was discovered to be low when production commenced, contrary to Pacific Northwest's anticipation (R. 734, 899, 901, 905, 910).

(ii) Pacific Northwest's financial condition was so poor that it could not drill its reserves and perform its existing obligations to producers, let alone be in the market for extensive additional gas reserves. Its major reserves in the San Juan Basin were located on leased acreage, and it was required to perform drilling obligations as provided in the

16. Following the stock acquisition in 1957, and in order that Pacific Northwest would not default in the payment of dividends on its preferred stock, El Paso purchased Pacific Northwest's stockholdings in Westcoast Transmission at market and gave Pacific Northwest the right to repurchase (R. 434).

leases or risk the loss of the acreage and the reserves contained therein (R. 905). That it lacked the financial resources effectively to carry on a program to develop wells was attested to by Pacific Northwest's Chairman, Ray Fish (R. 734-735):

> " . . . then we were faced with the realistic thing of developing the [San Juan] basin, I mean, of drilling up those reserves. And you could see thirty to forty to fifty million dollars overnight to drill them. And it was just impossible, I mean, to put our hands on that much money, and to put that much more money into the project of developing reserves when we could only get a trickle of gas out. In fact, the deliverability from the wells was so much lower than we had ever anticipated."

At the time of the acquisition, "take or pay" gas supply contracts with producers had also placed a heavy responsibility on Pacific Northwest's financial resources, and it had already paid approximately $7,000,000 under such contracts for gas it was unable to take (R. 925).

The President of Pacific Northwest, Stuart Silloway, pointed out (R. 907) that the slow development of the Northwest area which Pacific Northwest had been certificated to serve and the company's shortage of funds likewise meant that Pacific Northwest would be unable to encourage development of reserves in the Rocky Mountain area by offering financial inducements to stimulate drilling or by investing in gathering facilities or other field installations. (R. 900, 905-907)

C. The Purpose and Benefits of the Acquisition.

El Paso's purpose since the end of 1954 in seeking to acquire Pacific Northwest was to add to its existing gas resources to replace its supplies being exhausted in the

fulfillment of existing certificated obligations, to increase its ratio of "dry gas" to "residue gas," and to provide access to sources of supply in Canada and the Rocky Mountains. The District Court so found (Fdg. 40, R. 54), and this finding is not questioned by the Government.

In January 1957 El Paso acquired more than 80% of the stock of Pacific Northwest pursuant to its exchange offer of January 8, 1957, and by May 1957 had acquired 99.8% of said stock. On December 31, 1959, Pacific Northwest was merged into El Paso. (Fdg. 5) After the stock acquisition and merger, the combined resources were no more than sufficient to enable El Paso to fulfill its continuing certificated commitments in California (Fdg. 87, R. 63).

There is no evidence that El Paso had any anti-competitive purpose in acquiring Pacific Northwest, including any purpose to eliminate any alleged present or future competition to transport or sell gas to California. The District Court so found (Fdg. 40, R. 54) and this finding is not questioned by the Government.

The District Court likewise found, and it is not disputed, that the acquisition and merger had substantial public benefits and advantages. The stock acquisition and merger benefited consumers in California (i) by making available supplies and reserves needed to assure future deliveries under El Paso's already certificated contracts, and (ii) by substantially improving El Paso's ratio of "dry" gas to "residue" gas (Fdgs. 129-130, R. 71). In addition, consumers in the Northwestern states were materially benefited because, whereas Pacific Northwest's financial problems prevented it from assisting its distribution company customers to develop the market for natural gas in the Northwest (Fdg. 38,

R. 53), El Paso's financial resources enabled it, following the acquisition, to promote and develop that market. It provided extensive facilities and extensions to new areas which Pacific Northwest could not itself have undertaken, and El Paso has been able to maintain a rate structure in Oregon and Washington more favorable to consumers than Pacific Northwest could have maintained. Thereby competition in Oregon and Washington by natural gas with electricity and fuel oil has been more effective than it otherwise would have been.[17] (Fdgs. 127-128, R. 71)

B. The Structure of the California Market for the Sale of Natural Gas.

1. The Distribution Companies.

In order to understand the structure of the market for the sale of natural gas in California, it is essential to recognize the dominant position of the large distribution companies, Pacific Gas and Electric Company ("PG&E") and the so-called "Southern California Companies",[18] which by

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17. The competition between rival energy sources has been reflected in California in the appreciable inroads made by fuel oil on the demand for natural gas. For example, in 1961 PG&E lost some $5,000,000 in annual revenues to fuel oil, felt it necessary to reduce its gas rate schedules to industrial customers for the purpose of attempting to hold the market against the competition of fuel oil, and did so on terms which would result in absorption of the actual revenue losses by the stockholders of PG&E (R. 225-226).

18. These include Southern California Gas Company and Southern Counties Gas Company, subsidiaries of Pacific Lighting Corporation. The "Southern California Companies" are sometimes also known as the "Southern Companies" and are sometimes referred to, with their parent and affiliates, as the "Pacific Lighting group." Purchases by these affiliated companies are considered herein as a unit and they are treated as a single purchaser.

reason of their position are able to set their own respective buying policies and to select their own sources of supply.

Prior to 1946, California's natural gas needs were supplied wholly from intrastate sources. Since 1946, PG&E and the Southern California Companies have been the only purchasers of out-of-state natural gas for resale in California and, with limited exceptions, of intrastate gas as well. (Fdgs. 67-70, 73, R. 60-61)

PG&E is the largest operating public utility in the United States and distributes both gas and electricity. It is, and has been for many years, the only company authorized under the laws of California to distribute natural gas to the public in northern and central California. (Fdg. 68, R. 59)

As a result, PG&E is the only purchaser in its service area of interstate natural gas (and intrastate gas) for resale, as well as for boiler fuel used in the generation of electricity.

The Southern California Companies are the sole suppliers of interstate natural gas to the public in their respective gas service areas in southern California.[19] (Fdg. 69, R. 60) They do not generate and distribute electricity; but their two largest customers are the "interruptible" industrial purchasers, Southern California Edison Company ("Edison") and the Department of Water and Power of the City of Los Angeles ("Los Angeles"), the major electric utilities in the area which use natural gas as well as fuel oil for

19. San Diego Gas & Electric Company, which distributes gas in San Diego, and the City of Long Beach, which distributes gas in that city, are the only other distributors of gas to the public in southern California. The San Diego Company buys its gas from the Southern California Companies; Long Beach produces much of its own needs in Long Beach but buys supplemental supplies from the Southern California Companies (R. 178).

boiler fuel in the generation of electricity.[20] (Fdgs. 41-43, R. 54-55; Fdg. 95, R. 65)

Like PG&E in the north, the Southern California Companies are and have been the only purchaser of interstate natural gas for resale in southern California. (Fdg. 69, R. 60)

The position of PG&E and the Southern California Companies in their respective territories is such that all main natural gas transmission lines within California are owned by one or the other. And all interstate deliveries of natural gas are made at the border of California to one or the other of the two buyers, or both. (Fdg. 70, R. 60)

In recent years, in order to have a firm supply not dependent upon the Southern California Companies, Edison has unsuccessfully sought, and is still seeking, to purchase its own natural gas from out-of-state sources to use as boiler fuel in the generation of electricity (Fdg. 95, R. 65; R. 139-142). Los Angeles has been making similar efforts for this same purpose (R. 152-161).

2. Intrastate Natural Gas.

As a matter of policy in selecting their sources of supply, PG&E and the Southern California Companies have always purchased and are continuing to purchase the available supplies of intrastate natural gas in preference to out-of-state natural gas (Fdg. 73, R. 61; R. 183, 234).

There is substantial production of natural gas within California. Extensive discoveries of natural gas have re-

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20. Edison also buys from Richfield Oil Corporation some 42 million cubic feet per day of natural gas from intrastate fields under a long-term contract entered into after this suit was brought and not subject to approval by the Federal Power Commission or the State of California's Public Utilities Commission (Fdg. 74, R. 61). From 30% to 50% of Edison's boiler fuel is natural gas and the remainder is fuel oil (R. 1000).

cently been made both in the central valleys and offshore along the southern coast of California, and vigorous exploration is being carried on by the major oil companies. The recent discoveries have been described as occurring at an unexpectedly increasing rate, and their full extent has not been evaluated. (Fdg. 75, R. 61; R. 185-187, 234-235)

In addition, 600 million cubic feet daily of locally produced gas, which is presently used for repressuring operations in the production of oil, will become available when released from its present use (R. 184); the Federal Power Commission finds this will occur within five years.[21]

3. Out-of-State Natural Gas.

At the time of the acquisition and the commencement of this action in 1957, El Paso was the only supplier of the out-of-state natural gas demands of California, to the certificated extent of approximately two billion cubic feet per day (Fdg. 77, R. 61). The remainder of the gas requirements of California was furnished by intrastate gas sources (Fdg. 89, R. 64).

Since the acquisition and the commencement of this action and at the present, El Paso has ceased to be the only supplier of out-of-state natural gas to California (Fdg. 78, R. 61).

Beginning in 1956, prior to the acquisition, PG&E determined that it would obtain its future source of supply by direct purchase in Canada (R. 1050-1056). It did so, and this Canadian gas has been brought into this country by its affiliate, Pacific Gas Transmission Company ("PGT"),

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21. *El Paso Natural Gas Company*, 49 PUR 3d 113, 122 (July 12, 1963).

a pipeline constructed in 1960 at a cost of $133,000,000.[22] The PGT pipeline has a capacity of a billion cubic feet per day, of which to the present time PG&E uses only approximately 415 million cubic feet, leaving a remainder of approximately 600 million cubic feet daily to meet its requirements over the years to come. (Fdg. 80, R. 62)

PG&E's purchases in Canada and the setting up of its own pipeline were pursuant to its policy to get "control of our own gas supply." As the President of PG&E, Mr. Norman R. Sutherland, testified in 1958 (R. 1053):

> " . . . But we are determined to have our own line either to Canada or to the Gulf Coast, or wherever else we can obtain the gas. In other words, we want to be in control of our own gas supply, or a part of our supply, so that we can proceed with these large additional amounts of fuel that we need as and when we will, in a more flexible manner than has been the case in the past."

There seems no question that PG&E will avail itself of PGT's excess capacity to meet any future needs for interstate natural gas in its gas and electric service areas. Thereby this major distributor, which as indicated is the sole buyer of out-of-state gas for use in northern and central California, has established its control over the supply of such gas in that area for the foreseeable future. (Fdg. 80, R. 62)

In southern California, the Southern California Companies have utilized their position as the sole buyer of out-of-state gas to select the sources of supply with which they

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22. This figure relates only to the PGT line running from the International Border to California. The entire pipeline project to bring gas from the Province of Alberta to PG&E's service area in California also included lines in Canada and in California, and the completed line runs 1,400 miles and cost about $300,000,000. (R. 967) This averages out to a cost of about $214,000 per mile of pipeline.

wish to deal (R. 460-461). In 1958, having declined an offer of PG&E to supply them (R. 1056, 1095), the Southern California Companies entered into a long-term gas supply contract with Transwestern Pipeline Company for a supply of 300 million cubic feet daily. There was thus brought to southern California a new interstate pipeline organized by various producer interests (including Gulf Oil Corporation and Warren Petroleum Company) and authorized to be constructed to the California border at a cost of $191,000,000. Significantly, Transwestern has an ultimate capacity of 640 million cubic feet daily.[23] (Fdg. 79, R. 61.)

The Southern California Companies, following the example of PG&E, have also been exploring through an affiliate for gas and have acquired promising acreage, with a view to owning their own supplies and facilities (Fdg. 81, R. 62, 187, 896).[24]

Since January 1, 1957 El Paso has made no sales or deliveries of natural gas to California under long-term contracts in excess of its commitments existing on that date (Fdg. 88, R. 64). Moreover, El Paso has suffered an actual decline in its volume of natural gas sales in California (DX P, R. 998). PG&E, because of increased availability of intrastate gas, in 1962 and 1963 reduced its purchases under its contracts with El Paso to an estimated 82% to 85% of its contract commitments (R. 235). At July 1962, the most recent recorded date prior to the trial, the sales of

23. According to the Annual Report for 1962 of Pacific Lighting Corporation (p. 5), published since the judgment of the District Court herein, the Southern California Companies contracted with Transwestern in that year for an additional 50 million cubic feet daily commencing in November 1963, and an additional 100 million cubic feet daily commencing in November 1965.

24. According to the Annual Report for 1962 of Pacific Lighting Corporation (pp. 6-7), issued after the judgment below, this affiliate of the Southern California Companies has discovered new sources of supply of approximately 330,000 acres of leased rights in Utah and Colorado.

El Paso in California had declined to a point approximating its lowest daily sales since July 1959. (Fdg. 89, R. 64)

At the time of trial, there were pending before the Federal Power Commission two additional projects for the transportation and sale of natural gas to southern California, the so-called "Rock Springs" and "Pemex" projects (Fdgs. 82-84, R. 62-63).

The "Rock Springs" project—which was subsequently rejected by the Federal Power Commission on July 12, 1963, principally on the grounds that the gas was not needed at that time and that other methods of serving the California market appeared to be more economical[25]—was a joint project of Colorado Interstate Gas Company ("Colorado Interstate") and El Paso designed to offer 400 million cubic feet daily to the Southern California Companies. It represented Colorado Interstate's first venture into the California market. (R. 215, 216)

The "Pemex" project was subsequently withdrawn and superseded in early 1963 by the companion "Gulf Pacific" project designed to provide Edison and Los Angeles with a firm supply of some 865 million cubic feet of gas per day for use as boiler fuel. The gas would be purchased in the field by Edison and Los Angeles from Humble Oil & Refining Company and other producers in Texas and carried to Edison's and Los Angeles' generating plants through a pipeline to be constructed and owned by a subsidiary of Tennessee Gas Transmission Company. Since Edison and Los Angeles are major customers of the Southern California Companies, authorization of the Gulf Pacific project by the Federal Power Commission would defer the needs of the Southern California Companies into the indefinite future. Its denial

25. *El Paso Natural Gas Company*, 49 PUR 3d 113, 121 (July 12, 1963).

would not affect the availability to southern California of these enormous Texas gas reserves.[26]

In support of its characterization of Pacific Northwest as a "substantial competitive factor" in California, the Government relies heavily on Pacific Northwest's abortive effort in 1956 to sell 300 million cubic feet of Canadian gas per day to Edison. From that unsuccessful proposal, which required the participation of PG&E and the Southern California Companies and was summarily refused by each of them, the Government develops its unsupported assertion that Pacific Northwest today "would be one of four interstate companies seeking to serve California" (Gov't Br. 35); it presumably refers thereby to the current proceedings before the Federal Power Commission in which three other interstate pipeline companies, Transwestern, El Paso and Tennessee Gas Transmission Company, have submitted proposals. To avoid repetition, we will put the evidence concerning the Pacific Northwest-Edison negotiations in their context at pp. 38-41, *infra*. We point out here, however, that Pacific Northwest's interest in serving California in 1956 never got close to the stage of a project which could be brought before the Federal Power Commission for consideration.

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26. When the Federal Power Commission denied the "Rock Springs" project on July 12, 1963, it announced that it would institute comparative proceedings to determine the best method of meeting the future needs for natural gas in southern California, which it found would not arise before 1968. It therefore consolidated the Edison/Humble/Tennessee Gas Transmission Company project (the "Gulf Pacific" application) and applications of Transwestern and El Paso to serve the needs of southern California through the construction of additions to existing pipeline facilities and such new facilities as required. These applications are still pending, and the comparative hearing promises to be at least as complicated as the Rock Springs proceedings, which ran their course over a period of five years and were described by the Commission (49 PUR 3d 113, 115) as "among the most complex and difficult proceedings in FPC history."

The record shows there have been a large number of companies which, like Pacific Northwest, have at one time or another expressed their interest in selling or transporting out-of-state natural gas to California without developing their interest into a project for Commission consideration.

Mr. Grove Lawrence, an executive of the Pacific Lighting group, testified at the trial that the Southern California Companies have had various proposals for the sale of natural gas from a Mr. Hargrove, that they have been solicited by the Three States Company, that efforts to sell Mexican gas to them have been made by Mr. Pauley, and that some overtures, including correspondence, for the sale of gas from Mexico had been made by the Kurtz-Navarro combination. (R. 188-189)

The record also shows that Westcoast Transmission Company proposed to transmit Canadian gas to California, and negotiated with PG&E in 1954 for the purpose of making such a sale. (R. 469-70, 743, 781, 794, 1072-79)

Mr. Harold Quinton, President of Edison, testified (R. 1003-1008) that in the period between the date of the acquisition of Pacific Northwest in January 1957 and his negotiations with Tennessee Gas Transmission Company in 1958, Edison had carried on negotiations or had conversations with four other groups about an out-of-state gas supply.

Mr. Stanley Lanham, a consulting engineer engaged by the Department of Water and Power of the City of Los Angeles, and called by the Government as a witness at the trial, testified that in connection with his efforts in 1960 and 1961 to obtain a long-term supply on a firm basis, he conducted negotiations not only with the Southern California Companies, Transwestern Pipeline Company and Tennessee Gas Transmission Company, but also with the International Gas Company, California Gas Transmission Company (a sub-

sidiary of Tennessee Gas Transmission Company, which submitted an individual proposal as well as a joint proposal with Tennessee Gas Transmission Company), Richfield Oil Company and Occidental Petroleum Company. He testified that bid specifications for the firm supply had been requested by a total of 14 separate companies (among other companies not already named requesting such bids, he recalled the names of Texaco, Inc. and Pauley Petroleum).[27] (R. 153-167)

ARGUMENT

Introduction and Summary

It is common ground between the parties that natural gas is the "line of commerce" on which the effects of the acquisition of Pacific Northwest by El Paso may be tested (Fdg. 47, R. 55; Gov't Br. 2, 24). The Government, abandoning the rest of its complaint, also states (Gov't Br. 2) that its case should stand or fall on whether the effect of the acquisition may be substantially to lessen competition in the sale of natural gas in California. Since El Paso's position is that the acquisition did not have the proscribed anti-competitive effects in any "section of the country", El Paso can accept California as the geographical area within which to test the effect of the acquisition.

The parties also agree that the segments of market demand served pursuant to certification by the Federal Power Commission are removed from competition. It follows that efforts by an interstate pipeline company, such as El Paso or Pacific Northwest, to make sales of out-of-state natural gas to California would be directed to future market demands which are not already covered by certificated contracts.

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27. It also appeared in the comparative proceeding now pending before the Federal Power Commission that Amata Gas Corporation and Bolton and Company, as well as Gulf Pacific and the Southern California Companies, submitted proposals in 1963 on Los Angeles' requirements for a firm supply.

The Government has proceeded from this to argue in its brief that "competition in the regulated natural gas industry" (Gov't Br. 27), which it at another page characterizes as "competition among pipeline companies in this regulated industry" (Gov't Br. 25), consists of efforts "to obtain new contracts" or to put together "projects" to satisfy "new increments of demand as they emerge" (Gov't Br. 27, 29-30), for submission to and approval by the Federal Power Commission (Gov't Br. 25, 27).

The "competition" for the sale of natural gas in California as thus characterized by the Government is defined too narrowly and therefore erroneously. For one thing, competition to sell natural gas in California is not limited to the rival endeavors of interstate pipeline companies or even to out-of-state gas. Examination of the market structure in California makes it evident that competition for the sale of natural gas in California takes in (i) gas produced in California as well as out-of-state gas, (ii) the affirmative actions taken by PG&E, the sole buyer in northern and central California, to purchase its out-of-state gas requirements directly from producers and bring the gas to California through an affiliated pipeline, as well as the efforts by the Southern California Companies, presently the sole buyer of out-of-state gas in southern California, to acquire, develop and utilize its own sources of gas, (iii) the activities of major producers such as Gulf Oil Corporation and Warren Petroleum Company in supplying and participating in the formation of an interstate pipeline such as Transwestern to sell gas to the Southern California Companies, and of major producers like Humble Oil & Refining Company in selling directly to an industrial consumer such as Edison, and also (iv) the affirmative efforts of the major industrial customers themselves, Edison and Los Angeles, to bypass the Southern California Com-

panies by buying gas directly from Humble Oil & Refining Company and arranging for its transportation to their generating plants by a Tennessee Gas Transmission Company pipeline.

Moreover, the capacity to compete of a company without an existing pipeline to California is limited to "projects" of at least 300 million cubic feet per day, because throughputs of such quantities are required to make the construction of a pipeline economically feasible (R. 756-8).[28] There is no such limitation on a pipeline company such as, for example, Transwestern and PGT, both of which have excess capacity in their existing pipelines leading to California, which enables them to contract to bring additional supplies to market at incremental cost without the necessity of mounting a new and major pipeline "project".

A. Analysis of the market for the sale of natural gas in California makes it clear that El Paso's acquisition of Pacific Northwest has neither substantially lessened competition nor created a reasonable probability of a substantially lessening of competition in the future. It is conceded that El Paso has no advantage over its competitors to serve the future needs in California, and in various respects is at a competitive disadvantage. The dominant factors in the market are the two buyers of gas, PG&E and the Southern California Companies, which are in a position to select their own sources of supply. Both give preference to intrastate gas, the discoveries of which have been increasing. PG&E has already elected to control its out-of-state supply by buying directly from producers in the field and is now getting its gas from Canada and transmitting it to California

28. The Government offered no evidence that the proximity (550 miles) of Pacific Northwest's pipeline to possible delivery points on the California border would contribute to the economic feasibility of a project to California.

through an affiliated pipeline company, which has an excess capacity of some 600 million cubic feet a day over its present certificated deliveries. The Southern California Companies in 1958 selected Transwestern, backed by producers' interests, as another source of supply and Transwestern has an excess capacity over its present certificated deliveries of some 340 million cubic feet a day. The Southern California Companies are themselves in the process of exploring for their own supplies with a view to constructing the facilities to bring them to California. Meanwhile, Edison and Los Angeles are carrying forward their efforts to obtain a firm supply of natural gas for boiler fuel by purchasing gas in the field directly from Texas producers and having it brought to their generating plants through a pipeline proposed to be built by Tennessee Gas Transmission Company.

Since El Paso's acquisition of Pacific Northwest, therefore, the market for the sale of natural gas in California has been marked by the absence of any competitive advantage accruing to El Paso and by new and substantial entry in which the outstanding role has been that of the distribution companies. The facts as to the supply of interstate gas to California in the foreseeable future preclude the likelihood of anti-competitive effects resulting from El Paso's acquisition of Pacific Northwest.

Unmindful of the actualities of the structure of the market and of competition for the sale of natural gas in California and in disregard of the demonstrated inability of Pacific Northwest to provide effective competition in California, the Government's contention in this case ultimately comes down to the proposition that an independent Pacific Northwest would have been one of some four "substantial competitive factors" which would be interested in and would vie to put together major projects for such new

increments of demand for interstate natural gas in California as might arise in the future, and that its acquisition by El Paso *ipso facto* produced the effects proscribed by Section 7 of the Clayton Act.

We deal with Pacific Northwest's competitive ability in respect of California in Point B. Here, in connection with analysis of the market structure, we note that the Government's theory that there are less than a handful of companies which are interested and would vie to sell gas to California trips on the evidence. It is abundantly clear in the record that, in addition to the companies which (*unlike* Pacific Northwest) have succeeded in putting together projects for consideration by the Federal Power Commission, there have been numerous other companies which (*like* Pacific Northwest) have indicated their interest in selling gas to California but did not advance to the stage of putting together a project which could be brought before the Federal Power Commission. Any theory which, *arguendo*, would set Pacific Northwest up as a "competitive factor" in California would automatically encompass the score of other names in the record who have demonstrated their interest, not to mention the numerous other existing pipelines and producers with reserves within economic reach of California.

B. The characterization of Pacific Northwest as a "substantial competitive factor" flies in the face of the record, which established only that Pacific Northwest lacked the ability effectively to compete in California. Its record of failure in its 1956 negotiations involving Edison is proof of inability to compete and not a demonstration of the probability of effective competition for the future. The Government's analysis of the findings with respect to Pacific Northwest's ability to compete in California is both incomplete and erroneous. It fails to take account of the specific

findings that Pacific Northwest did not have the likelihood, had it remained a separate and independent entity, of being a substantial competitive factor in the sale of natural gas in California, and seeks to twist the findings on the record of Pacific Northwest's lack of capacity to put together a viable project into a requirement for a guarantee of certification by the Federal Power Commission.

C. Faced with the record of Pacific Northwest's demonstrated inability to compete effectively for the sale of gas in California, the Government resorts to a purported standard of proof which would relieve it of its burden of establishing a reasonable probability of a substantial lessening of competition resulting from the acquisition. It would substitute, instead, a requirement only to offer the basis for long-range speculation on future possibilities, to the end that it would take away from the Court the power to utilize the record in order to make a judgment on the probable effect of the acquisition. The Government's attempt so to rewrite the requirements for burden of proof is untenable. *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962).

A. The Evidence Is Clear That There Has Been No Substantial Lessening of Competition In The Sale of Natural Gas In California Since The Acquisition and That There Is No Reasonable Probability of Such Lessening In The Future.

1. Competition in California Since the Acquisition.

The structure of the market for the sale of natural gas in California since the acquisition demonstrates that competition has not been decreased by the acquisition, but in fact has expanded in several directions.

El Paso has long since ceased to be the only supplier of out-of-state natural gas to the state of California, and it is admitted by the Government that El Paso does not have any competitive advantage in California. Not only has El Paso been unable to make any sales under long-term

contracts in excess of its commitments on January 1, 1957, but its actual volume of sales has declined.

Since the acquisition two new interstate supply lines have been built to California. In northern and central California, PG&E, in pursuance of its policy to control its own gas supply, has proceeded with its plan conceived in 1956 to acquire its own sources of natural gas supply in Canada and transport it to California through its affiliate PGT.

In 1958 the Southern California Companies, without consulting El Paso or any other prospective supplier, entered into a contract with Transwestern Pipeline Company for 300 million cubic feet of natural gas per day through a new pipeline to California supplied from the reserves of Gulf Oil Corporation and Warren Petroleum Company.

2. Future Competition in California.

In this Court, the Government limits its claim of violation to what it postulates for the future. The Government apparently seeks to define the competitors of the future for the market of the future as being limited to those interstate pipeline companies which have actually supplied California in the past or are presently seeking Federal Power Commission approval to enter the state. It suggests that if Pacific Northwest had remained separate it would have been one of four pipeline companies vying to sell natural gas to supply increments of future demand with a new interstate pipeline system. Presumably the other three are Transwestern, El Paso and Tennessee Gas Transmission Company; even PGT is disregarded.

In view of PG&E's declared policy of acquiring its own sources of supply, it appears there will be no opportunity for any other supplier in northern and central California. Meanwhile, the certificated facilities of its affiliated pipeline

PGT, with substantial excess capacity, remain available to transport PG&E's future supplies.

The Southern California Companies have already taken steps to follow the lead of PG&E by pursuing active search for their own sources of supply, designed to make them a gas company vertically integrated from source of supply to the ultimate consumer. Meanwhile, the certificated pipeline facilities of Transwestern, which are now serving the Southern California Companies, have an ultimate capacity of some 300 million cubic feet per day in excess of their certificated contracts.

Edison and Los Angeles are committed by contract to the purchase of 865 million cubic feet of gas per day in Texas to be transported to California through the facilities of a pipeline proposed to be built by an affiliate of Tennessee Gas Transmission Company.[29] If the Federal Power Commission policy concerning firm supplies for boiler fuel is altered, as the Government predicts it might be, the huge volume of demand of these utilities would not only be removed from the area of competition for the definable future but the future new demands of the Southern California Companies, reduced by this loss of its existing customers' demand, would almost certainly be postponed indefinitely. If the Edison/Humble/Tennessee Gas Transmission project is not authorized by the Federal Power Commission, there will remain a huge source of supply available to enter the California market.

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29. Edison first contracted to buy gas directly from Humble and other producers in Texas in 1959, at a time when it was appealing to the Court of Appeals for the Third Circuit the Federal Power Commission's decision which rejected as an inferior use El Paso's proposal to sell gas directly to Edison subject to the peaking requirements and through the use of the facilities of the Southern California Companies. When Edison made its purchase from the producers in Texas it dropped the appeal. (R. 222-3)

This analysis of the future competitive picture in California demonstrates that any claim that the acquisition of an interstate pipeline company like Pacific Northwest of itself produced the proscribed anti-competitive effects is insupportable. We demonstrate in Point B that the Government's characterization of Pacific Northwest as a "'substantial competitive factor" in California is unsupported in the record. Even if it be assumed under the Government's theory that an independent Pacific Northwest would be a competitive factor simply because it could be counted as one other pipeline company in being (see Gov't Br. 35), the Government's attempt to restrict the count (including Pacific Northwest) to four cannot be maintained.

As detailed *supra* at pp. 28-29, the events prior to the time of trial indicate that, under a theory such as the Government's, numerous producers or independent promoters are available to attempt to develop a supply for any gas demand that may arise in the future. There is no reason to believe that the producers or promoters who solicited the Southern California Companies and expressed interest in selling natural gas to Edison and Los Angeles were less eager to sell natural gas in California than Pacific Northwest had been. Nor is there any reason to deny the proposition that these concerns and innumerable others are at least as eager and ready to offer service as Pacific Northwest would be if it were still in existence.

It may well be said, of course, that there is no evidence of the ability of any of these numerous concerns to serve a substantial future gas demand in California. But it is equally true in the case of Pacific Northwest that it had no pipeline to California and no undedicated supplies or facilities to offer, and no evidence was offered to prove how it could meet these obstacles or of its future ability to meet any new California demand for gas in the decades ahead.

On the contrary, as shown below, the only evidence on the subject was that at least at the time of the acquisition it was in no financial condition to do so, and also was certificated to serve the new Northwest market yet to be developed, and therefore it was much less likely to offer effective competition in the future than a concern unencumbered with its financial difficulties and its existing burdens.

In short, the market in the distant future which the Government assumes is one which, on its theory, will be open to any willing producer, pipeline or promoter, and there is nothing to indicate that Pacific Northwest would be in any better position, or in as good a position, as innumerable others. The elimination of Pacific Northwest from any such market, therefore, could not have any appreciable competitive effect.

B. There Was and Is No Reasonable Likelihood That Pacific Northwest Would Be an Effective Competitor for the Sale of Gas in California.

The Government's assertions as to future competition by Pacific Northwest in California, offered as a mere possibility and without reference to the competitive structure of the market, are based upon the thoroughly unsuccessful attempt by Pacific Northwest in 1956 to promote a project for the sale of Canadian gas to Edison for use as boiler fuel and upon some unsuccessful advances made by Mr. Fish to PG&E.

The Government reviews extensively the details of the futile efforts by Pacific Northwest as evidence of the latter's eagerness to enter the market, a desire which the Government predicts would have continued or been renewed in the future (Gov't Br. 36-39, 49, 52). This prediction of a continuing or renewed interest in seeking to supply a future California market is, in view of past failures and the obstacles which confronted Pacific Northwest, pure speculation. Whether or not Pacific Northwest would have considered

such an attempt worthwhile would have surely depended on numerous factors, including whether at any given time in the future, if Pacific Northwest were going to attempt to build any additional line at all, it would have preferred to go eastward, for example to the Chicago market as it had attempted to do in the past (R. 755).

With this comment, the approaches by Mr. Fish to Edison and PG&E may be dismissed. But the Government suggests that there was something akin to competition between Pacific Northwest and El Paso in 1956 before the acquisition.

The evidence is clear and without conflict in any particular that Pacific Northwest's effort was abortive and futile: the Edison project depended on participation by PG&E and the Southern California Companies because, for one thing, Edison could not take a sufficient volume to justify the project; both PG&E and the Southern California Companies flatly refused to deal with Pacific Northwest for Canadian supplies; the proposed arrangement thereupon collapsed for that and other reasons. (Fdgs. 90-93; R. 64-65; R. 149, 739; Gov't Br. 38)

It is asserted by the Government (Gov't Br. 38) that even the futile effort to meet Edison's desire for a firm supply in 1956 had a competitive effect in stimulating El Paso itself to offer Edison gas at lower prices. This is contrary to the evidence and findings. El Paso's offer was made only after Pacific Northwest was finished and Mr. Fish himself testified that El Paso had nothing to do with the collapse of his proposal (R. 127, 132, 149-50, 217, 756-758). There was also no reduction in El Paso's price of the nature claimed. The price basis was changed from a firm price to a formula price related to cost of service which eventually would have resulted in a price actually in excess of the firm price (R. 219-220).

It is also asserted by the Government (Gov't Br. 11, 38) that El Paso abandoned its policy about not selling directly to Edison. This is contrary to the record; El Paso policy was not changed. As the evidence shows without contradiction, El Paso agreed to sell under a three-way agreement in which its customer, the Southern California Companies, agreed to transport and deliver the gas to Edison subject to certain peaking requirements of the Southern California Companies. Indeed, the Southern California Companies participated in the negotiations (R. 216-219).

The utter futility of Mr. Fish's effort to sell boiler fuel to Edison was later made a matter of record, and a matter of law; for after El Paso agreed with Edison to provide a supply to Edison on terms satisfactory to Edison and the Southern California Companies, the Federal Power Commission refused to certificate it as an inferior use and not in the public interest (R. 126; 22 F.P.C. 900). See also *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961).

That Pacific Northwest was not a substantial competitor or potential competitor in California is further demonstrated by three basic facts. The possibility of Pacific Northwest's serving California was solely on the basis of an additional Canadian supply, an additional supply which to this day has not materialized (Fdgs. 91, 96, R. 64-65). El Paso's subsequent Twin Falls project for the sale of 400 million cubic feet daily to the Southern California Companies was based on the importation by Pacific Northwest of the natural gas from Canada, and failed because after three years of delay the gas supply was still unobtainable (R. 207-210). Indeed, no additional gas was obtained from Canada except 150 million cubic feet daily later delivered through PGT facilities to the Northwest (R. 233).

Likewise, the possibility of any such project was inevitably dependent upon the participation of PG&E, which has invariably rejected any such project because of its own project for the transportation of Canadian gas to California (R. 729, 737-740, 1094-1095).

Another basic reason for Pacific Northwest's inability to compete in California was its serious financial difficulties and operating problems. The Government concedes that Pacific Northwest was experiencing financial difficulties and operating problems when it was acquired, but points out that Mr. Fish was confident of overcoming the company's difficulties, balances Mr. Fish's optimism against Mr. Silloway's skepticism, reflects that experienced businessmen might differ on the company's ability to overcome these difficulties and undertake a large expansion program, and concludes that whether the company could have overcome its difficulties was a matter upon which the court could not find, because the question of Pacific Northwest's future ability effectively to compete is not a judgment for the District Court to make, either prospectively or retroactively, but for determination in the market place of the future through the processes of competition (Gov't Br. 58).

If, indeed, this is not a question for the District Court to decide, it is beyond understanding how a Court could find, as the Government would have had the District Court find, that a reasonable probability of substantial lessening of competition would result from the acquisition. Elsewhere, indeed, the Government argues that the Court should have made the finding that the resources of Pacific Northwest were such as to enable it to carry out the projects which it would propose to undertake (Gov't Br. 48-49), and that, upon the evidence, Pacific Northwest was capable of bringing competition to this area because it had theretofore

persuaded the Federal Power Commission of the feasibility of its original project to the Northwest and because of the confidence of Mr. Fish (since deceased) in his own personal ability to finance a line to California (Gov't Br. 55-56).

In *California v. FPC*, 369 U.S. 482 (1962), this Court held that the question of a substantial lessening of competition is in the domain of the Clayton Act and entrusted to the District Court. It does not seem open to question—indeed the effort by the Government to portray Pacific Northwest as a substantial competitive factor admits—that its financial condition and operating difficulties are a basic element in considering whether a pipeline is a substantial competitive factor in an industry where new projects cost many tens of millions of dollars.[30]

Pacific Northwest's lack of capacity to be a substantial competitor in the sale of gas in California was found by the Court upon a large body of uncontradicted evidence. The Company's failure even to approach its predicted earnings on the basis of the rate of return on which it was certifi-

30. Mere willingness or desire to make a proposal is not evidence of substantial competition in the natural gas industry. Section 7(e) of the Natural Gas Act provides that the applicant for a certificate be found to be "*able and willing*" to render the proposed service (emphasis supplied). 15 U.S.C. § 717f(e).

The Government appears to be saying at one point that considerations of feasibility, including financing, are exclusively for the Federal Power Commission (Gov't Br. pp. 58-59). However, that agency has already found, in the words of the Court of Appeals for the District of Columbia in *California v. FPC*, 296 F.2d 348, at 354 (1961), "that the elimination of Pacific as a potential competitor was not significant for two reasons: First, because of Pacific's poor financial condition it could not be considered a serious competitor to El Paso in California; . . ." The Court of Appeals found no error in this finding upon review.

cated and its financial inability to develop even its existing reserves are detailed *supra* pp. 17-18. Mr. Silloway, President of Pacific Northwest, made clear his opinion that it would have been difficult to obtain financing. He testified that although the Company was not insolvent, its earnings were far short of measuring up to predictions and the revenues were insufficient. (R. 902, 904, 915-916) It appeared to Mr. Kayser that Pacific Northwest at the time it was acquired by El Paso had bitten off all it could chew and "maybe a little more" financially, and because of that fact was in no position to build an additional line to the California border (R. 120-121). Indeed, its position was such, Mr. Kayser testified (R. 459-460), that he did not see how in view of Pacific Northwest's financial situation in 1956 it could make an effective offer to sell interstate gas in California then or in the future as far as one could see. Mr. Fish's testimony was not at all as optimistic as the Government suggests. Mr. Fish clearly described the financial difficulties involved in developing Pacific Northwest's reserves in his testimony quoted *supra* p. 18, and referred to its being "just impossible" for Pacific Northwest to raise the necessary $30 million to $50 million.

One can speculate that Pacific Northwest would have overcome the financial problems which confronted it in 1956 and in the years ahead, and developed its Northwest market to such a point that it could have been considered financially sound, and therefore capable of financing a new interstate project to California. But there was no evidence that it could do so, and certainly upon the evidence before the Court no reasonable probability that it would have done so in the foreseeable future. Indeed, with Mr. Fish's com-

plete confidence in his own ability to launch and finance an interstate gas project on a given source of supply and a satisfactory supply contract, it would appear to have been much easier for Mr. Fish, or any other entrepreneur, to have done so independently of Pacific Northwest and unencumbered with its acute financial problems and with the market obligations which it had already undertaken.

The Government's claim of competition by Pacific Northwest in California is at best a claim of a mere possibility, based on sheer suggestion, lacking substance or proof. It is clear from the findings that the District Court, as it was required to do, considered in the functional context of the natural gas industry whether Pacific Northwest had been in fact a substantial competitive factor in California in 1956, and found that the Government had not sustained its burden in that respect (Fdgs. 66, R. 59, 90-95, R. 64-65). It is also clear from the findings that the District Court considered, as it was required to do, the market in California further to test whether there was a reasonable probability of the acquisition and merger resulting in an injury to competition for the sale or transportation of natural gas to or for use in California. It reviewed the market demand for interstate natural gas in California in terms of specific buyers (Fdgs. 67-74, R. 59-61, Fdgs. 87, 90-95, R. 63-65), Pacific Northwest's potential to compete to supply that demand (Fdgs. 96-101, R. 65-66), and the availability of effective competition to supply that demand in California (Fdgs. 74-89, R. 61-64). It concluded on the basis of all relevant factors and all the evidence that the acquisition and merger did not have the prohibited effect on competition (Fdgs. 101-103, 108-109, R. 65-67). Its decision is clearly correct on the law and the facts.

C. The Government's Case Is Reduced to Speculation on More Possibilities Without Proof of any Probability of Substantial Effect on Competition.

At the outset, the Government concedes its burden to prove that Pacific Northwest was likely to have engaged in serious competition and to have become a substantial competitive factor in a future market for the sale of gas in California (Gov't Br. 51). Appearing to accept this burden, the Government points to Pacific Northwest's 1956 proposals to promote a project to serve Edison or PG&E, and from this assumes it to be reasonable that the desire to enter California would have continued in the years to come until a new demand might arise which would offer Pacific Northwest an opportunity to propose a new major interstate project. Having assumed this willingness to serve, it then predicts that a separate Pacific Northwest would somehow sooner or later have become a serious competitor to serve the new demand and, as such, ultimately a substantial competitive factor in the state.

No evidence was offered of any probability that Pacific Northwest, even if willing and eager and existing, would have been able to develop and present a proposal worthy of consideration in the market place or economically feasible. The possibility is simply offered that Pacific Northwest might have overcome all obstacles, although no evidence was offered even of this possibility. The Government argues, rather, that this was something which should have been left for future determination in the market place, without decision on the evidence by the Court that there was or was not a reasonable probability that Pacific Northwest would have been a significant competitor in the future. The total sum of this argument appears to be that the Government need only show a once expressed, although futile, effort to compete and its case is made.

The Government goes even further and, conceding that Pacific Northwest would not accomplish its purpose in the short run—that is to say, in the seven-year period since the merger, "or even in the years which lie immediately ahead" (Gov't Br. 60)—projects its speculations farther and farther from the present and from the facts until, as it states in its Brief (Gov't Br. 59): "The longer the perspective in which one considers the question, the greater becomes the probability that Pacific Northwest would ultimately have achieved its purpose of selling gas to California."

In the process of thus stretching the perspective so that the facts and the record disappear into the mists of conjecture, the Government reaches its ultimate conclusion that the District Court itself was speculating when it found on the record there was no evidence that the acquisition had any probability of substantially affecting competition (Gov't Br. 49-60). By looking far down the future years and speculating upon possibilities which can neither be proved nor contradicted by competent evidence, the Government seeks to ignore the facts about competition essential to an appropriate determination under Section 7 of the Clayton Act.

The Government does agree (Gov't Br. 55) that it must make a showing of violation of the Act—but only a "minimal" showing; that it has a burden—but only a "minimal" burden. But whether or not a minimal showing would suffice to support the case of the Government, a showing *de minimis* can hardly be one to compel the Court to find in its favor. And the case for the Government is surely *de minimis*, because it is grounded not on evidence but only on speculation of what Pacific Northwest might do in the future which seeks to ignore its failure in the past.

At this point the Government characterizes its attempts to look into the future and predict competition not as a "reasonable probability", the standard prescribed by Section 7 of the Clayton Act, but only as a "meaningful possibility".

All of this inexorably points up that what the Government seeks here is to relieve itself of any duty to offer evidence to prove the charge of violation of Section 7.

This effort is brought out in clearest form on the last page of the Government's brief (p. 60), where the essence of the Government's case on the question of Pacific Northwest's ability to market gas in California is revealed:

> "... there is no basis whatever for a speculative conclusion that Pacific would not in the long run be in a position to fulfill its declared objective." [Emphasis supplied]

and, again:

> "In the light of these overriding long-term considerations, the temporary disabilities under which Pacific Northwest may have labored in the very first year of its operation were insufficient to justify the conclusion that the company's elimination as an independent enterprise did *not* tend to substantially lessen competition." [Emphasis supplied.]

The position of the Government revealed here is that, contrary to its earlier acceptance of the duty to show a reasonable probability that Pacific Northwest would have been a substantial competitor, a decree of divestiture must be entered absent proof by the defendant that Pacific Northwest would never have vied for and could never have offered a competitive proposal. This is a neat but untenable reversal: instead of the Government's sustaining its charge, it is up to El Paso to negate by proof all possibilities of future competition by Pacific Northwest.

CONCLUSION

The facts and the legal issues concerning El Paso's acquisition of Pacific Northwest have now been examined (1) in relation to the Natural Gas Act by the Federal Power Commission and (2) in relation to the Clayton Act, upon direction of this Court in *California v. FPC*, by the District Court.

The Commission's finding that the acquisition was in the public interest was affirmed on review by the Court of Appeals for the District of Columbia.

The underlying question of the validity of the acquisition under the antitrust laws has now been thoroughly litigated by the Department of Justice in the District Court and a judgment rendered for the defendant upon findings amply supported by the evidence.

The Government now comes to this Court acknowledging that the greater part of its complaint was not justified. As to the remainder, we respectfully submit that the facts fully support the conclusion that there has not been and there is no reasonable probability of a substantial lessening of competition in the sale of natural gas in Cali-

fornia and that the judgment of the District Court should be affirmed.

Respectfully submitted,

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